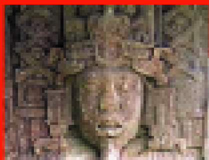
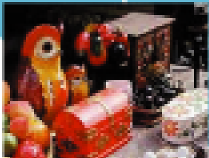
Modernising Credit Unions

-the Guatemala cooperative strengthening project 1987-1994



Paul A Jones

Liverpool John Moores University



MODERNISING CREDIT UNIONS

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Paul A Jones
Liverpool John Moores University

April 2002

Published and distributed by:
The Association of British Credit Unions Ltd (ABCUL)
Holyoake House, Hanover Street
Manchester, M60 0AS
Tel: 0161 832 3694, Fax: 0161 832 3706
Email: info@abcul.org
Website: www.abcul.org

Published 2002

ISBN 090506281-8-2

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Introduction

It was Lucy Ito, vice-president of the World Council of Credit Unions, who first suggested that the British credit union movement may have something very important to learn from the Guatemalan credit union experience. In the 1980s, most Guatemalan credit unions were small, economically weak and very dependant on external donor support for their operation and existence. However, in 1987, a process of credit union transformation began that resulted in the institutional and economic strengthening of a significant number of Guatemalan credit unions. From being small, relatively ineffective organisations, offering services primarily to the poor, these credit unions grew and were transformed into solvent, safe and effective financial institutions able to offer a wide range of financial services to a much larger cross-section the Guatemalan population.

The Guatemalan Co-operative Strengthening Project was established by the US Agency for International Development which contracted the World Council of Credit Unions to undertake a rigorous programme of financial stabilisation and institutional development with a designated number of credit unions. In Britain, we have had many examples of publicly funded credit union development programmes which have not resulted, with few exceptions, in the creation of significant numbers of economically independent credit unions able to serve large numbers of members with quality financial products. Even after substantial external support and public expenditure, many British credit unions have remained small and economically fragile. The British credit union movement can learn significant lessons from the Guatemalan programme of credit union transformation.

The Guatemalan strengthening project began by replacing the traditional social welfare model of credit union development with a more professional, business and market oriented model. It was in Guatemala that the new credit union development model, currently being promoted by ABCUL, was established and pioneered. The importance of having a new model was that process of transformation had to begin with people thinking about credit union management and operation in a radically new way. With this new thinking went a whole package of credit union reforms that were implemented simultaneously. These involved the rigorous implementation of financial and organisational disciplines as well as the professional modernisation of credit union business practices, policies and

procedures. It was a tough, demanding programme which challenged the ideas of many credit union volunteers and staff members. It introduced a level of technical expertise and financial monitoring into credit unions that had previously been noticeably absent. It was in Guatemala that the PEARLS monitoring system was created as a key management tool to promote the process of change. The results of the Guatemalan project were impressive and long lasting. Participating credit unions were able to free themselves from dependency on external donor funds and establish themselves as viable financial businesses. Importantly, and perhaps a point that needs initial clarification, the fact that strengthened Guatemalan credit unions were able to reach a larger and broader range of the population did not result in credit unions moving away from the poor. Strengthened credit unions were able eventually to introduce new low transaction cost loan products aimed at the lower income market which in themselves were profitable to the credit union.

The British credit union movement has already adopted the new credit union development model and the PEARLS monitoring system was introduced by ABCUL in March 2002. What perhaps British credit unions have yet to learn is the extent of technical expertise, financial discipline and institutional reform that is necessary to create truly effective co-operative financial institutions.

My thanks go to Brian Branch and David C. Richardson of the World Council of Credit Unions, Madison, Barry Lennon of the United States Agency for International Development, Washington D.C. and Oswaldo Oliva, Guatemala Ratings Agency, Guatemala City, for their help and assistance in the preparation of this paper. I particularly thank Brian Branch for the foreword he has contributed to this publication. This paper was originally written as part of the European-funded project *Getting the Framework Right: Public Support Frameworks for Local and Micro Finance.* I would like to thank Maritza Rodriguez of the New Economics Foundation for setting out the context of this project in section three of this publication.

Paul A Jones
Liverpool John Moores University

Developing Safe and Sound Credit Unions

In his paper, Modernising Credit Unions, Paul Jones writes an accurate and insightful review of the Guatemala Cooperative Strengthening Program (CSP). The CSP broke old myths and taught new ironies to guide credit union development. Credit unions in Guatemala, with a social mission to help the poor, found that when they were weak, they were actually harming the poor. They were unable to return the savings to the poor because of unrecoverable loans, poor management and returns well below inflation. Weak credit unions were unable to attract savings and had to ration loans. Although nominal rates on loans were low, few could receive the loans, loans tended to be much less than what the borrower requested and effective rates were well above market rates.

By becoming more disciplined, credit unions found greater freedom. Credit unions that committed to financial disciplines and met soundness standards, were less subject to economic or financial shocks. They were able to invest in well paid professional staff, development of new services and better service to their members. They stood in a position of credibility and strength in policy dialogue with their government.

By becoming more businesslike, credit unions were able to better serve their social mission. Through commitment to financial discipline, they provided a safe place for the poor to store their savings and a strong return on those savings. They were able to attract more savings to fund loans in the amounts that members demanded and when they wanted them as long as the member was able to repay the loan. Although nominal loan rates were higher, they remained lower than alternative lending sources in the market and lower than the effective rates charged under the traditional multiple of shares schemes.

By working within disciplines, credit unions found greater freedom. Credit unions found that financial disciplines made them strong. From a position of strength, they realized greater capacity to make decisions for expansion of services to members, to control their own destiny and to dialogue with their regulators.

By receiving savings of the poor, the credit unions were able to serve more of the poor than when they focused only upon

lending to the poor. The CSP ended the notion that poor people cannot save. Credit unions found a host of poor savers looking for a safe place for their savings. Credit unions served 10 savers for every one borrower.

By expanding service to all income and wealth groups, the credit unions were able to provide better service to more of the poor. Formerly dedicated to only serving the poor, the credit unions reached out to all sectors of society. Credit unions attracted more wealthy net savers who sought a safe place and a competitive return. This provided more funds to lend to the lower income borrowers. By lending to a wider range of economic activities, occupations and income levels, the credit unions were able to diversify their risk, reduce losses and boost profitability, enabling them to provide better services to their members.

Deeper outreach to serve the poor was achieved not through targeting the institution but through targeting the products within a sound institution. Merely serving more people was not enough to provide better service to the lowest income. Credit unions found that they needed to develop specific services and products tailored to the needs and the convenience of the lowest income groups in order to reach downwards to the lower income groups.

The lessons of the Guatemala CSP have assisted the World Council of Credit Unions guide its social mission in developing safe and sound credit unions around the world.

Brian Branch
Vice President
World Council of Credit Unions

Getting the Framework Right: Public Support Frameworks for Local and Micro Finance

"Modernising Credit Unions – The Guatemala Cooperative Strengthening Project 1987 – 1994" case study was produced as part of a European-funded project *Getting the Framework Right: Public Support Frameworks for Local and Micro Finance*, which addressed the issue of effective public support for social banking, specifically for the new sector of local and micro-finance that has emerged to serve people, sectors and regions that mainstream banks are not willing or able to finance. *Getting the Framework Right* was run by a group of leading experts in community development and micro-finance from across the EU, including the New Economics Foundation in the UK, Fondazione Choros in Italy, Evers & Jung in Germany, and INAISE, the international association of social investors based in Brussels.

At the heart of the project, was the fact that although there are many well intended national and EU support programmes for local and micro-finance, many are ineffective mainly due to fundamentally different "money cultures", which are characterised by public authority procedures (budget cycles and output driven, etc.) that do not match well with market mechanisms for delivering effective services. Concrete outputs of this project —15 case studies available in www.localdeveurope.org, including the "Modernising Credit Unions" case study, and a handbook— were produced as tools for public officials and practitioners to assess the potential of different public support measures. It was also the purpose of this project to facilitate networking among regional, national and EU officials willing to contribute to "new forms of welfare management".

The Guatemala Cooperative Strengthening Project (CSP) is a good example of how a public-funded development programme can enable local finance organisations —in this case credit unions— to play a unique role as self-sustaining financial institutions serving primarily low and middle-income households. Through a process of technical assistance and training, the policies, practices and disciplines of participating credit unions were upgraded in ways that were quite new to Guatemalan credit unions. The results were impressive: CSP credit unions made the transition from being inefficient and fragile organisations to becoming competent and sound financial institutions able to deliver quality services to clients with limited or no access to mainstream financial services.

The results from the *Getting the Framework Right* research on effective public support measures for local and micro-finance are now being disseminated through a new European-funded project *Financial Engineering for Local Employment: Opportunities for Local and Regional Government,* which is being delivered by an expanded European partnership involving the New Economics Foundation in the UK, Evers & Jung in Germany, Agence Alter in Belgium, Fondazione Choros in Italy, Eficea in France and Documenta in Spain. More details are available in www.localdeveurope.org.

Maritza Rodriguez
New Economics Foundation

MODERNISING CREDIT UNIONS

- the Guatemala cooperative strengthening project 1987 – 1994

INTRODUCTION

1. The Cooperative Strengthening Project

From 1987 to 1994, the US Agency for International Development (USAID) contracted the World Council of Credit Unions (WOCCU) to undertake an institutional development programme aimed at stabilising and strengthening cooperative organisations and credit unions in Guatemala. Although the programme was directed at a number of agricultural and commercial cooperatives, support for credit unions became its central focus. This case study concentrates solely on the credit union aspect of the Guatemala Cooperative Strengthening Project (CSP)

For policymakers involved in deciding whether public funds should be allocated to credit union development, the Guatemala CSP is a good example of how a public-funded development programme can enable credit unions to play a unique role as self-sustaining financial institutions serving primarily low and middle income households (Barham and Boucher 1994). CSP was a programme both of financial stabilisation and institutional reform. It aimed at both at strengthening credit unions as solvent and safe organisations and at modernising them so that they could compete effectively in a competitive market economy. Through a process of technical assistance and training, the policies, practices and disciplines of participating credit unions were upgraded in ways that were quite new to Guatemalan credit unions. The results were impressive. CSP credit unions made the transition from being inefficient and fragile organisations to becoming competent and sound financial institutions.

This process of transformation and change was neither easy, quick nor cheap. The whole programme took nearly eight years and cost $5 million, of which $3 million went in direct support to credit unions. It involved credit union directors and staff having to radically re-think the principles and practices of credit union management and implement fundamental reforms so that credit unions could operate as effective financial institutions within the difficult economic environment of the time. In place of the traditional credit union focus on providing credit for poor people, mainly with the support of external, international donor funds, credit union directors and staff

were presented with new business orientated objectives that spoke of responsiveness to market demands, profitability, credit risk analysis and capitalisation. Undoubtedly some credit union people did feel that something of their traditional socially-oriented credit union philosophy was being lost in the change to a market-driven, business approach to development. However, given the success of the project, CSP has now been recognised by Guatemalan credit unions as a major contribution to their effectiveness, soundness and sustainability. 20 credit unions participated in CSP and all experienced significant increases in membership, loans outstanding, deposit savings and retained earnings.

2. The United States Agency for International Development

USAID is the federal government agency which supports international economic development programmes in developing countries. It follows the political agenda of the US administration of the day and generally aims at stabilising regions of the world that fall within the US sphere of influence. It particularly supports private sector initiatives that strengthen the skill and productivity base of weak economies. To this end, it has focused on enabling micro-entrepreneurs, particularly women and the very poor, to gain access to financial and business development services to improve their capacity and performance. As institutions that provide financial services to micro-enterprise, USAID has supported the development of credit unions in Central and Latin America for many years (USAID 1985). The aim has always been to reach and benefit the rural and urban poor who are not otherwise served by banks, other private sector institutions or direct government programmes. Support for credit unions has also been regarded by USAID as facilitating local economic democracy in countries with unstable political regimes.

CSP was funded completely through the Guatemala Mission of the United States Agency for International Development. No additional complementary funding was accessed during the project although participating credit unions were obliged to commit staff time and resources to the programme. The grant was awarded, through a bidding process, to WOCCU which was the lead and accountable body for the project. In Guatemala, CSP was administered through the National Credit Union Federation (Federación Nacional de Cooperativas de Ahorro y Crédito - FENACOAC). For the duration of the project, USAID, WOCCU and FENACOAC formed a tripartite

partnership through which the programme was delivered to credit unions.

3. Background to the setting up of the project

Prior to 1987, USAID's support for credit unions was seen as a way of ensuring viable mechanisms for channelling external funds for on-lending to poor entrepreneurs and individuals (Richardson 2002a). USAID, the World Bank and the Inter-American Development Bank were all agencies that traditionally offered credit unions funding and technical assistance so that they could support poor entrepreneurs with low-cost credit.

For about 20 years, Guatemalan credit unions developed relatively steadily. However, in the 1980s, the political and economic climate in Guatemala worsened. Not only was there political upheaval stemming from the civil war, the debt crisis and globalisation destabilised Guatemalan financial markets. Credit unions were confronted with rapid inflation, currency devaluation, volatile interest rates and increased competition from alternative financial providers. In addition, external credit subsidies from international donors declined significantly. By 1987, Guatemala credit unions were suffering severe organisational difficulties. They had stagnated and their viability was threatened.

In response to this situation, USAID sought to introduce a new stabilisation and support programme that would free credit unions from dependence on external donor funds. The development of CSP was assisted by some key people at USAID who already had technical knowledge of the economic situation and institutional profile of Guatemalan credit unions. Their knowledge of the reality of the situation within credit unions facilitated a new and radical approach to their development.

WOCCU was the agency appointed to carry out the stabilisation programme after successfully bidding for the project. WOCCU was responsible for the design of CSP and, from the outset, was clear that the approach to the stabilisation of credit unions had to involve their institutional reform.

The third partner in CSP was FENACOAC, the Guatemalan national trade association. Initially all CSP contact with Guatemalan credit unions was through FENACOAC. This not reflected the traditional way USAID had worked with credit unions in the past (external funds

were always directed through FENACOAC), it indicated an initial hesitation with regard to the programme. FENACOAC was interested initially in further external funding for on-lending. In the context of failing credit unions, it was also attracted by the opportunity of a stabilisation fund to write off bad debts. USAID and WOCCU had to work hard to gain the trust and confidence of FENACOAC, and to convince its key officials, before FENACOAC accepted the necessity of radical institutional reform and recommend direct CSP staff contact with its credit union members.

4. The World Council of Credit Unions (WOCCU) and The Guatemalan National Credit Union Federation (FENACOAC) – Establishing the Project Team

WOCCU operates as a worldwide representative organisation for credit unions whose membership is made up mainly of regional and national credit union associations drawn from 91 countries throughout the world. In Europe, national trade associations in Great Britain, Ireland, Poland, Romania, Russia and the Ukraine are members of WOCCU. In Guatemala, the WOCCU member trade association is, of course, FENACOAC.

WOCCU provides technical assistance and developmental programmes for credit unions throughout the world particularly in developing countries. The Guatemala CSP was a key learning experience for WOCCU insofar as it involved facilitating a fundamental transformation of credit unions from small, socially-oriented organisations into fully independent and modern financial institutions. CSP was not implemented as a pre-planned, fully worked up programme. WOCCU had not really undertaken anything like it before. Its methodology, design and tools were developed through the direct experience of endeavouring to bring about change. This was one reason why CSP took so long. Current WOCCU strengthening programmes are rolled out in a much shorter time frame.

CSP was led by a management team of three people. A project director was appointed by WOCCU, an assistant director by USAID, the third team member was the CEO of FENACOAC. There were three additional staff members responsible for marketing, finance and administration. It was an independent project. WOCCU and USAID were clear that CSP, though administered through FENACOAC, had to be independent of the trade association. It could not be

compromised by the internal politics of FENACOAC or through the resistance of its member credit unions. High quality staff were recruited to the project team, all of whom had extensive financial knowledge and technical skills. WOCCU went for the best they could find within the private sector. The project worker responsible for organisational systems had worked for Price Waterhouse for 3 years, the marketing expert had worked for Sony and the finance person had a senior background in banking. Recruiting high quality staff was seen as essential to the success of the project. People were employed who fully understood the technical issues in the development of safe and sound financial institutions.

In general, the relationship between WOCCU and USAID was a positive one. USAID was sympathetic to the approach taken by WOCCU and it did not set the kinds of targets that were impossible or inappropriate to meet. The fact that USAID was represented by an active partner in the management team helped to build a close working relationship. USAID made the funding available in advance so that it could be invested throughout the project period. This helped particularly in the development of the stabilisation fund.

If WOCCU and USAID were able to build a positive relationship relatively quickly, their joint relationship with FENACOAC was more complex. Prior to 1987, USAID support to Guatemalan credit unions had been directed through FENACOAC. It had either supported FENACOAC to participate in regional confederations of trade associations or it had used it as a vehicle to channel external donor funds to credit unions for on-lending to their members. With the introduction of CSP, FENACOAC was presented with a completely new approach to credit union support. This involved a project team working with, and funding, credit unions directly in order to establish them as self-sustaining, independent financial institutions. This was not easy for FENACOAC to accept. Not only did it seem to some that FENACOAC was being undermined, but there was also the perception that the mainly American team was forcing Guatemalan credit unions to adopt a particular model of credit union development. An initial lack of confidence was also fuelled by the huge salary differences between CSP and FENACOAC staff. The trade association already employed a large number of credit union development workers, who were paid on a low salary and, in comparison with the CSP employees, were relatively low skilled in technical and business affairs. The argument for CSP was only won through patience, tact and an unrelenting focus on economic reality.

5. Credit Unions in Britain – Can Lessons be Learnt from Guatemala?

The issues faced by Guatemalan credit unions within the unstable political situation and volatile economy of the time were clearly quite distinct from those faced by British credit unions. However, certain themes emerged within the Guatemalan experience, and which were addressed in CSP, that have resonances within the current context of British credit union development.

Credit unions in both countries were established according to models of development that prioritised social over economic goals (Jones 1999) and both, as a result, suffered financial and institutional weaknesses. Consequently, they failed to make a significant impact within their respective financial markets. In both cases too, there has been a long term dependence on external funding. In the British case, this has been mainly in terms of financial support for premises, staff, training and organisational infrastructure rather than for finance for on-lending (even though currently more and more credit unions are accessing external finance to establish loan guarantee schemes which enable credit unions to lend to poorer, riskier members with the guarantee that any loan default will be covered by the external finance).

In Britain, as in Guatemala in 1987, a process of fundamental change is underway. The credit union movement and HM Government recognise that credit unions have the potential to make a *"positive contribution to increased access to financial services for low income groups, especially in deprived areas"* (HM Treasury 1999a). To achieve this goal, HM Treasury's Credit Union Task Force stressed that credit unions need to change and to develop as broader-based, business orientated financial institutions with the policies, procedures and systems necessary for them to provide a wider range of services and to attract savings. The Task Force recommendation, mirrored in HM Treasury's PAT 14 report (HM Treasury 1999b), was that credit unions need to adopt a new approach if they are to have the capacity to act as fully fledged financial institutions. This approach is not dissimilar to that of the new model of credit union development as pioneered in Guatemala.

The transformation of British credit unions into modern, economically stable financial institutions is a major commitment of the Association of British Credit Unions Ltd. (ABCUL), Britain's major credit union

trade association. A new model of credit union development is emerging that is more business and market orientated, more concerned with economic viability and with the provision of quality financial services. The "how" to bring about this transformation is the current challenge facing ABCUL and British credit unions in general.

In Britain, credit unions have received considerable financial support from public, mainly local government, sources. Previous research (Jones 1999) conservatively estimated that total public investment in credit unions reached £15 / £20 million per annum. For the most part, this public investment has not yet resulted in the creation of independent, economically viable credit unions able to offer quality services to wider sectors of the population. The radical CSP approach to transformation offers British credit unions some hard lessons in bringing about the change that is necessary to establish credit unions as fully fledged financial intermediaries.

THE COOPERATIVE STRENGTHENING PROJECT

6. Modernising Guatemalan Credit Unions – The Strategy

The aim of CSP was to assist credit unions to develop into sustainable and safe financial institutions that could effectively respond to the needs of the rural, agricultural and micro-enterprise economy in Guatemala. Banks and mainstream financial institutions had shied away from serving micro entrepreneurs and poorer consumers. Credit unions, on the other hand, were local and based in rural and smaller communities. They were well placed to fill a market gap by making available an alternative financial service for smaller savers and borrowers.

However, a diagnostic analysis of Guatemalan credit unions prior to CSP had identified that Guatemalan credit unions were financially weak and insecure organisations. Not only did they lack the institutional capacity to serve a greater proportion of the population, many were near insolvent retaining large uncollectable delinquent loan balances on their books. One of the first tasks of the CSP project team was to investigate the factors lying behind this poor institutional development. At first, project workers assumed that credit union weaknesses were a product of the external turbulent economic and political situation within Guatemala at the time. However, it soon became clear that the poor growth and economic vulnerability of credit unions was not primarily the result of external factors but rather a product of the internal organisation and financial

structure of credit unions themselves. The first task of CSP was to clearly analyse how the traditional model of development was preventing credit unions becoming economically viable.

CSP identified that the traditional credit union model was based on the theory that the rural poor lacked the resources necessary to save and to fund their own borrowing and development (Richardson 2000b). Guatemalan credit unions had been established with a strong social ethos, often with the support of the Church or other welfare organisations. Their primary purpose had always been to provide low cost loans for poor people who were unable to access other financial institutions. They did not prioritise the mobilisation of member savings. In fact, the only savings that were captured were in the form of shares that could only be withdrawn on termination of credit union membership. These share savings earned minimal interest, often only 2-3% in an economy with 15% inflation. Their main purpose was to provide a basis for borrowers to obtain low cost credit and loans were granted, often quite mechanically, as a multiple of the member's share balance (usually 3 to one). These share savings were not attractive to people who wanted to save. The result was that Guatemalan credit unions were unable to mobilise the savings of members and, in order to fund the credit needs of the poor, were dependent on international donors providing external finance.

This model was regarded by CSP as inherently weak. Non-withdrawable shares did not attract savers. Low cost loans did not generate sufficient income to pay dividends or generate capital reserves. On-lending of donor money often was done in the absence of effective credit administration systems with the result that heavy loan losses were regularly sustained. This meant even lower earnings and lower levels of capital reserves. In addition, the traditional model was not characterised by rigorous accounting practices and, as a consequence, financial statements often overstated asset values. Long delinquent loans were not written out of the accounts and current delinquency was not accompanied by adequate provision for loan loss. Under-capitalised traditional model credit unions were particularly vulnerable when external donor funds were not forthcoming. When this happened, there was a chronic shortage of funds, loans had to be rationed to members with yet greater loss of income to the credit union.

The solution to this problem was to develop an alternative and modernised model of credit union organisation and structure that

would address the weaknesses in the traditional model and strengthen credit unions as economically sound financial institutions. The strategy adopted by CSP, therefore, was to persuade credit union directors and staff to adopt a radically changed approach to credit union organisation and financial structure. It aimed to replace the traditional social welfare model with a more professional, business and market orientated model of credit union development.

Following Richardson, Lennon and Branch (1993), the main elements of the new credit union model were: -

- attracting deposit savings – the central element of the new approach was the emphasis on attracting the savings of members, "*the project's paradigm shift*" (Richardson 2000b). CSP encouraged the creation of new deposit accounts which could be withdrawn easily and which received a competitive rate of interest. CSP stressed that it was only by attracting savings, and thus amassing loanable funds, that credit unions would be able to free themselves from dependence on external, and necessarily uncertain, donor funds and become fully fledged financial intermediaries.
- market rate on loans – in order to pay a competitive rate of return on deposit savings, credit unions had to increase earnings which, CSP stressed, required the use of market rates in lending. This would prove to be a particular contentious issue within the programme as it meant that interest rates on small loans, mostly made to poor people, had to increase.
- capitalisation of earnings – when credit unions mobilise the savings of members, adequate capital and bad debt reserves become much more important in order to protect savings. In the traditional model, shares had been regarded as capital. CSP argued that shares were ultimately withdrawable albeit on termination of membership and, in fact, were regarded by members as secure deposits. CSP directed credit unions to maximise and retain earnings as capital reserves as a means of building institutional strength. CSP set the goal of retaining 10% of assets as capital reserves.
- repayment based credit analysis - CSP promoted the redesign of the administration of credit. Rather than loans being granted on a simple share to loan formula, they were

to be based on the capacity of the member to repay, the available collateral or guarantee and the conditions attached to the loan made.

- marked-based, results orientated business planning - CSP approach to model credit union development was to focus clearly on economic goals. It argued, as central to the paradigm shift, that social goals could only be achieved through economic and business success.
- improved financial information reporting, control and evaluation. – CSP introduced rigorous monitoring and reporting disciplines and a system of peer evaluation through which the progress of credit unions was compared one with another.

Table 1 compares the focus of the new credit union model to that of the traditional model (Richardson 2000 b).

Table 1 The New Credit Union Development Model

Area	Traditional focus	New focus
1 Ideology		
Mentality	Social/business	Business/social
Attitude	Reactive	Proactive
Economic activity	Diverse activities	Specialisation in financial services
Policies and standards	Diverse criteria	Standardisation
Membership	Lower-income groups	Diverse groups
Image and market presence	Poor	Professional
Products	Credit and shares	Savings and credit
Technology	Antiquated	Modern
Information	Inadequate	Transparent and clear
2 Legal		
Credit union law	Outdated and generalised for all cooperative institutions	New specialised law for credit unions
Regulation	None	Formal sector regulation or self regulation
3 Human resources		
Technical knowledge	Insufficient	Well-trained
Experience	Inadequate	Professional
Compensation	Inadequate	Competitive
Turnover	High	low

4 Financial Structure		
Financing	Shares and external credit	Savings deposits
Capital	Member shares	Reserves
Capitalisation	Obligatory share contributions	Capitalisation of all net income of the operating period to institutional capital
5 Interest rates		
Loans	Below market rates	Entrepreneurial rate that covers all credit union costs and expenses and maintains institutional capital at 10% of total assets
Savings deposits	Not competitive	Competitive rate that protects against inflation
Shares	None or inferior to the inflation rate	Equal to or greater than the savings deposit rate
6 Financial discipline		
Accounting	In arrears and not balanced	Balanced and on time each month
Transmittal of financial information	Intermittent	By the 10th of each month
Financial indicators	Diverse criteria	PEARLS system
Delinquency ratio calculation	Diverse calculations	Entire delinquent loan balance outstanding
Creation of loan loss reserves	None or inadequate	According to ageing of loan delinquency
Net income distribution	Dividends to membership	Capitalise 100 per cent to legal reserves
Liquidity reserves	Not specifically allocated	Require 10 percent of total savings plus time deposits
Annual business plan / strategic plan	Inadequate/none	Prepared annually and controlled monthly
Annual external audit	Inadequate/none	High-quality certified public accounting firm
7 Marketing		
Buildings and public areas	Old and Inadequate	New and remodelled, comfortable
Furniture and equipment	Depreciated	Modern

Research studies	None/intermittent	Covering market area
Marketing plans	None/limited to promotions of publicity	Complete and integrated with the business plan
Dress code	None	Professional
8 Credit		
Credit analysis	Limited, based on member shares	Based on the five C's of credit: Character, Capacity to pay, Capital invested, Conditions of loan and Collateral
Loan amounts	Restricted due to inadequate funds	Flexible, based on risk
Loan purpose	Restricted due to inadequate funds	Flexible, based on sources of funding
Guarantees	Inadequate/not registered	Solid, convertible to cash, and registered

taken and adapted from Richardson (2000 b)

7. Design of the Cooperative Strengthening Project

In designing the programme, the CSP team found that it was essential to implement a whole package of reforms simultaneously. At the same time as instituting reforms to prevent losses and stabilise the credit union financially, it was important to put in place more proactive institutional reforms that improved managerial competence, competitiveness and business practice.

The design of CSP was based on five interrelated and interwoven components (Branch 1993), none of which could be implemented without the other four. These were financial stabilisation, institutional development, savings mobilisation, credit administration and external supervision and monitoring.

1. Financial Stabilisation Financial stabilisation was the key incentive that attracted Guatemalan credit unions to buy into the whole package of CSP institutional reforms. Credit union directors and staff knew that their credit unions were under-capitalised and economically fragile due to historic loan losses and inadequate delinquent loan provision. The CSP stabilisation component offered credit unions an injection of financial resources to write off bad debts and to improve capital adequacy and solvency over a specific period of time. These financial resources were the "carrots" which persuaded credit unions to undertake the whole programme.

Financial stabilisation began with a rigorous identification loan losses. Stabilisation funds were then allocated equal to the accumulated losses. However, funds were not allocated directly to the credit union. They were invested in a finance company in the name of the credit union and the interest accrued over time reinvested in the finance company until the conclusion of the stabilisation process. This accrued interest was used to write off bad debts and to build adequate reserves for future delinquent loans.

Participation in the stabilisation process was conditional on the credit union establishing and maintaining rigorous financial management disciplines. Credit unions were obliged, through a signed stabilisation-management agreement, to enforce delinquency and internal control policies, capital reserve standards, improved credit administration and the control of operating costs. In addition, the granting of stabilisation funds was conditional on participation in the institutional development component of CSP and meeting set financial and operational targets. Failure to maintain disciplines and meet targets meant expulsion from CSP. Technical assistance and training in establishing new financial and operational disciplines was given to staff members. Volunteer members of boards of directors were encouraged to share the vision of financial stability and economic growth.

2. Institutional Development The institutional development component aimed to professionally modernise the business practices, policies and procedures of participating credit unions. Support in the form of advisory services, training, and marketing assistance was given to credit unions and grants were available for marketing programmes, upgrading buildings, facilities and information technology. Specific technical assistance and training was organised to upgrade the financial management and accounting competences, business and leadership skills of staff members. Within this, a clear focus was placed on developing strategy, market penetration and improving service delivery. The aim of the institutional development programme was to ensure that credit unions developed into modern, stable financial institutions able to offer a range of financial services to their members.

As with the stabilisation component, credit unions were obliged to meet certain agreed requirements and targets as a condition of continuing as participants in the institutional development programme. Compliance with these conditions was strictly monitored and the disbursement of finance remained a liability to the credit union until CSP were satisfied that the credit union had successfully completed its operating plan. These conditions covered establishing and updating credit procedures, pursuing a marketing plan, undertaking a financial audit, participating in training for directors, managers and staff, increasing share and deposit savings by a stated percentage and increasing membership by a stated number (Branch 1992). Non-compliance resulted in exclusion from CSP.

CSP stressed that external finance granted to credit unions had to be reported as extraordinary income and was not allowed to diminish efforts to become economically viable. With the same emphasis on self-sufficiency, finance for marketing was only given on condition that the credit union provided match funding from its own resources.

3. Savings Mobilisation A central component of CSP design was the stress on aggressively pursuing the mobilisation of savings. The project team were insistent that this was the "driving force for internally generated growth" (Branch 1992, Richardson 2000b). Credit unions were discouraged from using credit or finance from external sources for on-lending to members. The maxim was: only funds that were saved were to be lent. Reliance on external finance, Richardson has argued, is the traditional weakness of micro finance programmes. It neither enables poor people to amass wealth through saving (Richardson 2000a) nor does it build the strength of the financial institution. CSP facilitated the creation of deposit savings accounts, which paid a competitive rate of return, and were attractive to savers.

4. Credit Administration CSP was designed to improve loan evaluation criteria, loan administration and delinquency control. A repayment based credit analysis approach to lending was introduced based on the member's character, commitment and capacity, collateral or guarantees and conditions of the loan.

5. External Supervision and Monitoring CSP facilitated the adoption of financial disciplines and enforced regular examination and monitoring within participating credit unions. CSP developed a new monitoring system called PEARLS which was used to analyse the financial structure and growth rates of credit unions (see section 12 below). PEARLS became a key management tool within the programme.

8. Implementing CSP

The dynamics of implementing CSP were not easy. The project team were convinced that credit unions had to adopt a new business-oriented development model if they were going to succeed as successful financial institutions. However this meant convincing people to think about credit unions in quite different way. As Richardson points out, *"the long difficult process of changing the way people think is by far the most difficult aspect of modernisation"* (Richardson 2000b). Through a process of education, training, persuasion, a constant focus on economic reality and the use of incentives CSP aimed at changing the mindset of the directors and staff of participating credit unions

One of the first issues to be tackled was the use of the funding. FENACOAC wanted to channel the external funding through to credit unions for on-lending in the traditional manner. The CSP team was clear that no external funds could be used for lending by CSP participating credit unions. All loanable funds had to be generated through aggressively pursuing deposit savings mobilisation (in fact $1 million had been set aside in the original bid as a credit fund for on-lending by participating credit unions but it was never used). Through a process of discussion, FENACOAC was eventually convinced that savings mobilisation was the only effective way of building institutional strength.

The first part of the programme aimed at building relationships and establishing trust between CSP, FENACOAC and credit union staff. After FENACOAC's original hesitation about CSP contacting credit unions directly was overcome, the decision was taken by CSP to work primarily with credit union staff. As these were the people taking operational decisions about credit unions, CSP decided that the bulk of the training and technical assistance had to be directed to staff. Volunteer directors, who in Guatemala at that time often used

to serve for just a few years, were kept informed and were invited to a number of seminars. However, CSP considered that the best placed to keep volunteer directors informed were the managers and staff. CSP had consequently reduced contact with volunteers. This did cause some friction between managers and volunteers, who felt sometimes that they were not receiving a great deal through the programme. However, this was resolved usually between directors and staff themselves and away from the CSP team.

An important element of CSP was that it was very hands on. CSP staff were recruited for specific specialisms whether in marketing, finance or organisational systems. They were not generalist credit union workers. They were all highly skilled, coming mainly from senior positions within the private sector. They spent a lot of time, individually and in small groups, with credit union staff. There was a lot of small group discussion in which issues were tackled in depth. Consequently, CSP was not a sequential programme of training. The team responded to the needs of credit union staff as these arose. There were seminars and technical training workshops but 80% of the time was spent coaching and mentoring staff in individual credit unions. The resources available, 5 CSP staff for 20 credit unions over nearly an 8 year period, permitted this high level of one-to-one involvement.

CSP applied a methodology that integrated organisational diagnostics and planning, performance measures, funding, training and technical assistance. The CSP institutional development component began with a diagnostic of the market potential and economic viability of the credit union. This was a rigorous assessment of the credit union's market penetration, administration, savings mobilisation, credit assessment, delinquency, capitalisation, operational efficiency, policies and procedures. On the basis on this diagnostic assessment, a business development plan was drawn up aimed at strengthening the policies and procedures, service quality, management skills, accounting practices and credit union systems. The plan defined the development strategy of the credit union and the financial goals for the period. Participation in the institutional development component was subject to meeting the targets set in the development plan as defined in the legally binding institutional development agreement *(see section 7.2 above)*

The process of stabilisation was equally rigorous and was aimed at establishing permanent financial disciplines in the credit union. It began with the identification of losses. Funds were allocated and

invested and the interest used on these to write off bad debts and restore reserves *(see section 7.1 above).* The legal representative of the credit union, its board members and the legal representative of CSP signed a legally binding financial stabilisation agreement in the presence of a solicitor. The credit union was obliged in the agreement to follow financial, administrative and management requirements as well as meet specific targets in regard to the growth of loans, deposit and share savings, members, capital reserves, investments and assets.

The demands of the institutional development and stabilisation agreements were not always accepted easily. Particularly contentious was the obligation to charge higher rates on loans. In order to maximise earnings to offset the higher cost of funds due to paying competitive interest rates on deposit savings, credit unions had to charge market rates (or a few percentage points below) on loans. This was difficult for the CSP team to sell to credit unions as it meant, in fact, charging poor people more for credit. *"It was a constant struggle. We first managed to convince the credit unions to raise their rates to 1.5% per month",* reported one of the CSP staff members, *"and, after about a year, again increased those rates to 2% per month".*

It also took a long time too for the CSP team to convince credit union managers for the need to build capital reserves. Credit unions had poor reserves as they considered members' shares to be more than sufficient to cover any loss. CSP countered this by arguing that members regarded shares as "savings" and, if they were told that their shares were at risk, it was very likely that members would not invest in them at all. Today, Guatemalan credit unions actually treat members shares as though they were savings by provisioning monthly for the annual dividend rate. Eventually, credit unions hope to eliminate the difference between the interest rate paid on deposits and the dividend rate on shares, but as yet, there still exists a difference although much less than it was. CSP firmly stressed that all earnings had to be entirely capitalised, as part of the stabilisation agreement, until a ratio of 10% of assets was achieved.

The process of transforming credit unions into professional, viable market-oriented businesses came up against resistance constantly. The move away from what was seen as a social model of development was the big issue. Credit union staff and volunteers sometimes felt that the ethos and philosophy of credit unions were being lost in the pursuit of economic and financial goals. There was a

perceived loss of identity too - *"we are becoming just like banks"*. Some felt the movement was being Americanised with all the import and feeling that arouses in Central America. Others felt that they were being forced to adopt just one business model of development and that they had little choice about it. Some felt that CSP was only interested in the bigger credit unions and were ready to let the smaller unsustainable ones collapse. There were issues too around perceived loss of control by volunteer boards. They were not used to employing highly skilled staff and were suspicious of CSP focus on the upgrading of the skills and abilities of managers. Overall, directors and staff found it difficult to cope with the paradox that, in order to achieve social goals more effectively credit unions had to develop a much clearer professional and business focus.

CSP staff moved the credit unions on mainly through persuasion, argument and a focus on economic reality. However, CSP did rely also on incentives, the *"carrots".* Participating credit unions were offered access to the stabilisation and institutional development programmes, including financial resources, if, and only if, they accepted, in a legal contract, the new model of credit union development and committed themselves to achieve set financial and organisational goals. There were some softer *"carrots"* too. Participating staff and directors had the opportunity of visiting Puerto Rico, and other international locations, in order to see the new business model in practice.

9. Process of Gaining Access to CSP

Credit unions gained access to CSP through an evaluation process conducted by the CSP management team. In order to participate in CSP, credit unions had to meet defined and pre-existing operational and eligibility criteria. Entry into CSP was not automatic and not all credit unions that wanted to participate were able to do so. In Guatemala in 1987, about 25 of the 92 existing credit unions accounted for about 80% of credit union assets (similarly, in Britain today, about 50 out of more 600 credit unions hold 80% of credit union assets). The CSP approach was to select the 21 strongest credit unions in the country and to ensure that these were stabilised and functioning as effective financial institutions. By establishing a strong core group of credit unions, the CSP idea was that they would eventually act, through the intermediacy of FENACOAC, as role models and mentors for smaller credit unions. Since CSP, there is

evidence that this "*spill over effect"* has indeed been effective. FENACOAC has now in place definite operating criteria for all member credit unions wishing to remain part of the national association.

Credit unions wishing to participate in CSP had to submit a written request accompanied by a complete financial report of the credit union. This report included historical data on the past performance of the credit union including membership trends, loan portfolio management, delinquency and income generation. In addition, credit unions had to provide copies all written financial policies and procedures which affected savings and capital formation (Branch 1992).

The criteria by which credit unions were selected for CSP were as follows. They had to: -

- exhibit economic potential
- operate within a viable market area and demonstrate growth prospects. This was assessed through a market and feasibility study prior to participation in CSP.
- have the disposition and desire to change. CSP regarded this as a critical element of success and applied to both directors and staff members.
- have the staff and resources to commit to a demanding development programme
- prepare an approved development plan
- increase loan interest rates to cover operating costs and the building of new reserves
- participate fully in the training and institutional development programmes.

In evaluating each credit union's application, the CSP team also took into account: -

- the need for assistance – financial aid had to prevent the insolvency of the credit union and promote its development
- the causes lying behind the credit union's need for assistance – these may have included poor management, inadequate credit administration polices and delinquency control. If fraud or embezzlement were involved a change in the management of the credit union was required.

- the effect that assistance would have on the members. Participation in the programme had to result in an enhanced public image and improved service for members.

The level of responsibility demanded by CSP from participating credit union directors and staff was at a much higher level than anything requested by public funding programmes in Britain. CSP was based on a clear understanding that directors and staff members accepted responsibility for the stabilisation and development of their credit unions. They had to sign legally binding, formal stabilisation and institutional development agreements that personally obliged staff and directors to ensure that the credit union maintained financial disciplines and achieved identified financial and organisational targets. Regular monitoring and evaluation took place to ensure continued compliance. Ultimately, failure to maintain financial and organisational disciplines and meet set targets meant that the credit union lost access to the programme and its financial resources. Of the 21 credit unions selected to participate in CSP, however, only one credit union was expelled from the programme throughout the entire eight year period.

The decision of CSP to work with the 21 strongest credit unions was seen as an important aspect of the programme. CSP did organise some technical training sessions that were open to all credit unions but most of CSP time and commitment was spent with the selected CSP credit unions. These larger credit unions, even though they had staff, premises and existing policies and procedures, were, however, institutionally weak and in need of strengthening. CSP considered that, for the future development of the Guatemalan credit union movement time and resources had to be spent on credit unions that had a good chance of success. Their success, it was considered, would assist others to be successful in turn. Interestingly, many of the smaller credit unions were undisturbed by not being included in CSP. As one CSP staff member put it, *"they were so small that they really did not understand the issues. They did not care they were not in CSP".*

ANALYSIS

10. Level of Coherence

CSP assisted credit unions to become secure financial institutions that were independent and economically viable and that were able to compete effectively within a free market. Technical and financial

resources were oriented primarily towards improving credit union operations and ensuring that members' money in credit unions was safe. As the funder, USAID was clear that credit unions had to be, first and foremost, viable business enterprises whose *"development effectiveness is measured by the same standards as other private organisations"* (USAID 1985) WOCCU shared this perspective and designed CSP so that credit unions were enabled adopt a business like approach and meet definite economic and operational targets.

Traditionally, FENACOAC had regarded credit unions quite differently. For Guatemalan credit union directors and staff, credit unions were primarily organisations that had a social purpose and that were established to meet the needs of the poorest and most excluded members of society. For many years credit unions had served poor farmers and indigenous peoples (Barham and Boucher 1994). Initially, FENACOAC was concerned more about ensuring that financially excluded people obtained the credit they needed rather than credit unions having to meet hard economic and institutional targets.

At first sight, it may appear that WOCCU/USAID and FENACOAC were coming to credit union development so differently that there was a total lack of coherence between what the funder was offering and what the credit unions felt they needed. Certainly this perceived lack of coherence caused many initial difficulties between the team, FENACOAC and credit union staff. The team was even accused of being the *"IMF of credit unions"* and undermining credit union philosophy and values. CSP's contention that interest rates on small loans to riskier and necessarily poor borrowers was accepted initially with disbelief. CSP were clear, however, that no social goals could be achieved by credit unions that were institutionally weak and near insolvent. CSP was not exactly top-down but it most certainly was directive and was not willing to compromise on the final goal of the safety and soundness of credit unions as financial institutions. The ability of CSP to be directive, of course, arose from the *"carrot"* of the stabilisation fund. In reality, credit unions had to radically change or face eventual insolvency. The success of CSP was that FENACOAC and Guatemalan credit unions did accept, as the programme progressed, that credit unions, if they were to serve low and middle income groups effectively, had to adopt more rigorous business disciplines. In other words, the new model of credit union development was seen by FENACOAC as ultimately coherent with its own credit union ideals.

From a British perspective, public funding for credit unions has had a very different focus to that of the USAID programme. For the most part, British public funding programmes have tended to favour social rather economic targets. Unlike USAID, most British programmes, whether funded through central government or local authority mainstream funding or European structural funds, have set targets that have been traditionally more people rather than institution oriented. Instead of goals linked directly to economic growth, financial structure, asset quality, capitalisation and solvency, British funders have tended to stress membership growth and volunteer participation and training. Linked to this, they have tended to employ programme staff from a generalist community or social background rather than high calibre technical, financial and organisational experts. British funders have not made credit unions contractually obliged to meet economic and organisational targets in return for public investment. Given the overall poor results of public investment in credit unions in Britain, it could be argued that it has been this investment based on a social model of development that has lacked coherence with the real interests of credit unions as financial institutions.

11. Performance and Impact

CSP bought about a significant growth in credit union membership, assets, savings deposits, loans and capital reserves within the period of the programme. Overall it improved the professional image and economic stability of participating Guatemalan credit unions. By establishing new institutional policies, financial disciplines and a regular system of monitoring and examination of progress, CSP enabled credit unions to maintain growth subsequent to the programme. In the period 1987 to 1992, CSP credit unions increased capital reserves from 5% of assets to 9%, decreased loan delinquency from 19% to 9% and increased deposit savings by 589% in nominal terms. The following table illustrates the growth of CSP credit unions during the programme and for three years afterwards. Following CSP, the 20 participating credit unions continued the process of modernisation with the support of FENACOAC and only occasional visits from WOCCU.

Table 2 Financial Results for 20 CSP credit unions 1987 – 97
(Thousands or real 1997 dollars, except for total membership)

Year	Total Assets	Loan portfolio	Savings Deposits	Member Shares	Capital Reserves	Net Earnings	Total m/ship (thousands)
1987	20,601	12,885	5,051	9,698	1,028	343	60
1988	22,994	14,305	5,691	10,470	1,255	494	65
1989	25,042	15,673	6,884	11,024	1,474	548	66
1990	21,168	11,629	7,224	8,284	1,397	444	72
1991	24,958	14,686	9,732	9,449	2,144	703	76
1992	30,053	17,482	14,368	10,502	2,695	559	80
1993	35,855	24,556	17,631	12,262	3,832	985	90
1994	45,703	29,838	25,009	13,748	4,934	1,405	104
1995	58,064	41,055	30,944	16,181	6,571	1,835	120
1996	71,081	47,504	39,355	18,440	8,265	2,019	174
1997	94,362	54,487	58,784	20,909	10,432	2,918	200

(taken from Richardson 2000b)

One of the most significant effects of the modernisation programme was the increase in savings deposits as a consequence of the policy of savings mobilisation. This resulted in credit unions increasingly freeing themselves from dependence on external funding and making advances in self-sustainable development. Among all CSP credit unions, external financing as a percentage of assets fell from 18% in 1987 to 6% in September 1992. A survey of seven CSP credit unions in 1992 confirmed that deposit savings had replaced external funding as the main credit union source of loanable funds (Boucher S., Barham B., Branch B.A., Cifuentes M., and Ronquillo A.1992). Increased deposit savings enabled credit unions to increase lending, and as this was conducted at market rates of return, credit unions were able to increase income and build capital reserves.

The new business model of credit union development had an impact on the membership profile of credit unions and their niche within Guatemalan financial markets. As confidence grew in credit unions as secure financial institutions, more middle-income and professional people became members. They were attracted both by the competitive interest rates on deposit savings and by the possibility of obtaining larger loans which credit unions were now able to make by loosening the loan linkage to shares and by instituting capacity-to-pay lending polices. As Barham and Boucher (1994) discovered, the result was that credit unions offered much greater access to credit to many lower and middle-income people. In particular, small business entrepreneurs were better able to obtain capital for commercial opportunities. However, the drawback was that the poorest of members, with little assets, had greater difficulty in obtaining credit after CSP.

It was the new credit administration policies and practices that made it more difficult for the very poor to access loans as they had done in the past. Not only were loans more expensive, poorer classes of borrower found it more difficult to meet the more rigorous capacity-to-pay loan assessment criteria. Often they could not obtain a loan because of the lack of collateral or other repayment guarantees. This was a major issue within credit unions as they shifted to the new credit union development model. Credit unions were faced with the hard economic reality that they could not lend to poorer, riskier borrowers and be assured that they would earn sufficient income to cover costs and maximise capital reserves. In the past, of course, losses incurred through delinquent loans were covered by external donor funds. In 1987, in many credit unions, delinquency rates were 20-30% and sometimes even reached 60%. After CSP, it was the members' own money that provided loanable funds and potential loan losses had to be minimised drastically. This was a hard lesson for Guatemalan credit union directors and staff to face as they endeavoured to resolve the apparent clash of their economic and social goals.

However, this move away from serving poorer borrowers should not be overstated. Research demonstrated that CSP credit unions continued to provide small loans at lower costs to low-income members (Barham and Boucher 1994). The average loan size in 1991 was about 1700 quetzales which compared with 34,900 quetzales in banks. In fact, after CSP, many low income entrepreneurs, with very modest assets, were better served by credit unions through being able to access larger loans and receive interest on their savings. In their study of three CSP credit unions, Barham and Boucher found that modernised credit unions were able to fill a major niche by mobilising savings and making loans available to households engaged in small to medium-scale agricultural and commercial enterprises. The majority of these borrowers would have found bank loans too costly and, particularly as one fourth were illiterate, would have found bank administration very difficult to access. Barham and Boucher concluded that, *"No other private or public financial institution provides a similar scale or scope of financial intermediation to this sector of the population*" (Barham and Boucher 1994).

Low income borrowers still tended to invest money into shares to qualify for loans, whilst wealthier member tended to place money in deposits for market rate returns. The impact of the latter was that

CSP credit unions experienced a rapid increase in savings during and after CSP. At the same time, a certain conservatism in lending, linked to higher interest rates charged on most loans, resulted in a reduced demand for loans. The result was excess liquidity and a falling loan to asset ratio over time; liquidity ratios were 63% in 1997 and 56% in 1992 in all CSP credit unions. In fact, Guatemalan credit unions are now cash rich and the current challenge is discover how to more effectively invest funds in the same communities from which those savings are mobilised.

As an example of the impact of CSP, it is interesting to look at Unión Popular which was one of the CSP participating credit unions. It was founded in 1972 with 50 members in the town of Tiquisate where 30% of the population were involved in agriculture. At the end of 1996, two years after CSP had finished, Unión Popular had grown to 10,732 members, had a share capital of $936,214, deposit savings of $3,734,363 and 3719 loans outstanding amounting to $3,527,373 (Almeyda and Branch 1999). In 1996, it was run by a board of directors of five people and a credit committee of two. It employed a general manager and 46 other staff members at its head office and two branch offices. During CSP, Unión Popular saw both its institutional and financial structure change radically. From 1987 to 1991, shares increased by 28%, deposit savings by 343%, loans by 126% and membership more than doubled from 2345 to 5,446 (in four years). Membership reached 11,082 by February 1997. As in other CSP credit unions, since the early 90s, Unión Popular's marketing strategy has been geared much more towards mobilising savings rather than credit. In1994, it offered a competitive 15% interest rate on deposit savings which was slightly higher than the banks. Through mobilising savings, Unión Popular was able to reduce external borrowing significantly and increase the capital reserves to assets ratio to 13% in 1994.

The profile of Unión Popular's membership diversified through the programme. At the start of project, most of its members tended to be poor rural agricultural producers. Through an improvement of its public image and range of services, Unión Popular succeeded in attracting a relative wealthy section of small to medium scale agricultural and commercial producer households (Barham and Boucher 1994). This change in membership profile was reflected in loan growth throughout the period. Table 3 illustrates how growth rates in commercial and personal loans, generally larger loans and accessed by wealthier members, exceeded agricultural loans from

1987 to 1991. Unión Popular charges varying competitive rates on loans; in 1994, it charged 24% on personal and agriculture loans rising to 36% for commerce and small enterprise loans. Unión Popular reduced loan delinquency from 16% in 1987 to 5% in 1996 (Almeyda and Branch 1999).

Table 3 Unión Popular Real Loan Growth 1987 – 1991

	Agriculture	Commerce	Housing	Personal	Total
Real Growth of Loans	94%	194%	71%	196%	126%
Real Growth of Average Loan Size	-3%	52%	-6%	54%	16%
Growth of Number of Loans	99%	94%	82%	93%	94%

(Barham and Boucher 1994)

12. Institutional Learning

Guatemala CSP was a new development for WOCCU and, also, for USAID and FENACOAC. When the CSP team first went to Guatemala, it had the general concept that credit unions needed to adopt a much more market-oriented and business approach, but it was less clear about what this meant in practice. There was no blueprint of a new model of credit union development and no means of assessing that model in operation. It was only through the CSP process that both the design of a new model and its implications in practice became clear and apparent. What emerged out of Guatemala, however, was a radical new approach to credit union development programmes

The first learning outcome, as identified by CSP staff in interview, was the importance of conducting a thorough diagnostic of each credit union before implementing a development programme. The diagnostic enabled an assessment of the market and economic viability of the credit union and a rigorous analysis of reserve levels, delinquency, policies, procedures and operational efficiency. Guatemalan credit unions were often good at glossing over financial and institutional reality. They overestimated capital reserves, downplayed loan delinquency and had a blinkered view of their economic viability and potential. The team learnt the importance of ensuring that credit union directors and staff were honest with

themselves about economic reality and that they faced into the issues as revealed in an in-depth analysis of the credit union's finances and operations.

Learning to communicate the message that credit unions needed to undergo radical institutional reform if they were to succeed as independent financial institutions was central to CSP. According to CSP staff, it took several years to convince Guatemalan staff of the need to implement fundamental changes to the financial structure and operation of credit unions. Communication meant a lot of hands-on coaching by people who were respected for their technical knowledge and expertise in finance, organisational systems and market analysis. It involved developing relationships and trust between CSP staff, FENACOAC and credit unions. For even though CSP set a clear direction, to which credit unions had to commit themselves in writing, this did not mean that changes could be imposed from above. Credit unions had to want the changes for themselves otherwise CSP advances would terminate with the conclusion of the project.

In communicating with credit union staff, CSP also learnt never to compromise on the safety and soundness of credit unions as financial institutions. For a development programme to succeed, it was essential to insist that credit unions had to adopt and maintain rigorous financial disciplines and operating standards in order to protect members' savings. For this reason, CSP would not compromise on not using external donor funding for on-lending. In fact, the funds in the budget, originally allocated for credit purposes, were never used. *"Money to lend is money that is saved"*, became the motto of the project.

CSP identified, as a central institutional element of development programmes, the need to implement a package of reforms simultaneously. This was regarded as of fundamental importance and explained the insistence on institutional reform for credit unions in receipt of stabilisation funding. Financial disciplines, credit procedures, marketing plans, improving quality of service, policies and procedures, establishing sound accounting practices and the setting up of a planning system all had to be undertaken as essential elements of the programme.

A key learning outcome of CSP was the detailed identification of the new credit union development model. Having this model allowed credit unions to better understand their purpose and rationale, and

also to recognise key elements of successful credit union development. This model was based on the following principles: -

- *Credit union are first and foremost a business*
- *Credit unions are savings institutions*
- *Credit unions do not depend upon external subsidy*
- *Credit unions must build capital reserves;*
- *Credit unions must offer competitive interest rates on savings and charge near market rates on loans.*
- *Credit unions are professional financial institutions;*
- *Credit union employees must be capable, well-trained, and competitively paid*
- *Credit unions are for everyone (adapted from Richardson, Lennon and Branch 1993)*

Perhaps the most significant and most internationally recognised outcome of the Guatemalan project has been the development of the PEARLS monitoring system. Somewhat similar to the CAMEL System used in the United States, the PEARLS System was designed, through CSP, as a management tool capable of measuring key areas of credit union operations. It enabled managers to identify problems and find solutions for any institutional deficiency. PEARLS was originally designed, in Spanish as PEARLAS, each letter standing for: -

- P - Protección (Protection) – refers to the adequacy of loan loss provisions
- E - Estructura financiera (financial structure) – measures loans, assets, savings, shares and reserves as a proportion of total assets
- R – Rendimientos y costos (yields and costs) – measures rates of return
- L – Liquidez (liquidity) – measure liquid investments and reserves against withdrawal deposits
- A – Activos impoductivos (non-earning assets) – measures loan delinquency and non earning assets
- S – Señales expansivas (signs of growth) – measures the growth rates of total assets, loans, deposits, shares, capital reserves and membership.

For each indicator the new credit union of development identifies target ratios by which individual credit unions measure institutional strength, economic viability and growth.

Finally, with the development of PEARLS, CSP discovered the need to instil internal competition as part of a development project. Each

month, the project publicised 45 PEARLS ratios for all participating credit unions. At monthly managers' meeting, these ratios were discussed and it was pointed out who was doing well and who was not doing well and why. The discussions focused on the issues each credit union was facing and identified action points for the next month.

OVERALL ASSESSMENT

13. Strengths and Weakness of CSP

The calibre of the CSP team was a strength of the programme. WOCCU pitched this project at a much higher level than would normally be the case within public funded support programmes in Britain. It stressed the importance of employing people with huge financial knowledge and technical skills. It brought experts from the private sector and was ready to pay them appropriately. At first, this caused real problems for FENACOAC whose staff members were much less skilled and paid appalling wages. By the end of the programme, however, FENACOAC realised the importance of highly skilled staff within development programmes. It reduced its own staff force and took on project staff at higher rates of pay.

CSP was a very focused development programme. It started from the clear premise that credit unions were, primarily, financial institutions and had to operate on a basis of firm financial disciplines, entrepreneurial business plans, standardised accounting systems and comprehensive marketing programmes. Its clear goal was the economic independence and financial viability of participating credit unions. The move towards greater clarity of purpose within public supported programmes within Britain is currently being promoted by ABCUL. Unfortunately, in the past many public funded development projects have set targets not directly related to the institutional strength of credit unions. Social goals linked to the personal development and training of volunteers have often predominated. The result has been limited results in credit union growth and market share.

CSP was a well resourced development programme linked to appropriate targets. Funds were not a problem and the financial arrangements were supportive of a flexible approach to the programme's development. In fact, USAID paid all the money in advance. This was unusual arrangement for USAID but it did allow CSP to invest funds and establish the stabilisation fund at favourable

rates. There were some targets that were inappropriate. For example, CSP had to ensure that 8,500 volunteers and staff attended training programmes throughout the period of the project, a target met often through extensive double counting! However, targets were, for the most part, linked to PEARLS ratios and directly related to the strengthening of credit unions as financial institutions.

The "carrots" were an undoubted strength of CSP. Project staff recognised that without the stabilisation fund, the programme would have been much slower and maybe not achieved the same sort of results. It was the attraction of the funds to write off of bad debts that facilitated agreements to reform the credit unions both financially and operationally. The visits to Costa Rica were also positive for participants saw there modernised credit unions within a Latin American environment.

The choice of working solely with credit unions that exhibited economic potential and financial viability was seen by CSP as a strength of the programme. In Britain, with hundreds of small credit unions requiring strengthening such a policy may be seen by many as a weakness. However, for CSP, whose aim was the transformation of a national credit union movement, it was judged to be the best way forward. All participating credit unions had many of the basics already in place - staff, systems, premises and IT – albeit they were financially and institutionally weak. These credit unions offered the best opportunity of success. Many of the smaller credit unions were so financially weak they eventually closed or, as they failed to meet FENACOAC's basic operating standards, were expelled from the national association.

A lasting strength of CSP was of the development of a credit union market niche in Guatemala. Mushinski (1995) found, in his research into credit unions in three regions of Guatemala, that CSP credit unions had made a positive impact in serving a segment of the market which had little access to banks. This segment was made up primarily of low and middle-income households that were engaged in commercial and agricultural business activities. CSP credit unions were able to offer credit facilities at lower costs than the banks and were able to continue to serve this market after the closure of the project. In general, CSP's continuation strategy was a success. Some project staff and a number of credit union staff that were trained within CSP now work for FENACOAC which has itself adopted PEARLS and the new credit union model of development as standard practice. FENACOAC credit unions are now subject to

regular monitoring and review and are trademarked as safe and sound credit unions. Of the original 92 FENACOAC credit unions, which had in 1987 76,000 members in total, only 28 now remain in the national association. In 2001, these had between them 350,000 members. FENACOAC credit unions represent 88% of the members and 92% of the assets of all Guatemalan credit unions in 2001.

A weakness of CSP was perhaps the fact that the poorest of households and smaller micro-enterprise businesses remained unserved by CSP credit unions. Mushinski (1995) found that households with zero land and low asset levels had a low probability of obtaining a loan. It has to be recognised that CSP credit unions were not able to serve everyone. Undoubtedly, this was a consequence of building a reputation as a prudent lender and achieving economic viability, but the challenge remains to design programmes that enable credit unions to make credit available to the poorest of members. If the emphasis on the repayment capacity of prospective borrowers excludes poorer members, credit unions need other methods of loan eligibility assessment. In fact, in Guatemala, there have been some moves to the continued use of share accounts for smaller loans and, as in Britain, allowing the withdrawal of shares when there is no loan outstanding.

The shift of credit union membership towards a wealthier, urban segment of the producer population and away from the traditional rural poor may be seen as a weakness of CSP. Certainly it was an important issue for credit unions in Guatemala. As in all credit union movements endeavouring to modernise, the question remains as to how credit unions can they continue to serve poorer members with low cost loans whilst modernising sufficiently to extend the involvement of wealthier households in savings and credit activities and achieve economic self-sufficiency.

From the USAID point of view, there was one constant weakness of CSP that caused complaints from the funder. To demonstrate that credit unions were meeting the needs of low income groups, small businesses and women, USAID needed basic statistical data as to the breakdown of micro enterprise loans and personal loans made by participating credit unions. CSP were unable to supply the information USAID needed due to the weak credit union management information systems. This is the sort of weakness that is not unknown in Britain too.

14. Suggestions for Improvement

There is no doubt that CSP was slow and expensive process. For a period of nearly eight years, a staff team of 5 highly paid experts worked very closely with 20 credit unions. Of course, improvements in the delivery and timescale of strengthening programmes have already been achieved through a greater definition of the new model of credit union development and the design of the PEARLS management tool. The current Romanian credit union strengthening project is a four instead of an eight year programme. Implementation of CSP, or similar programme, in Britain funded though public expenditure would still need to be rolled out much more rapidly.

The most evident gap in CSP was the lack of any work with the Guatemalan Government to develop appropriate credit union legislation and regulation. In fact, there was no credit union legislation in Guatemala at the time and credit unions were subject to basic cooperative law that was not always appropriate to their needs. Neither was there any Government regulation of credit unions. USAID has recognised that CSP should have focused more on national legislation and that this an area of work yet to accomplished. However, the problem was that the team were not equipped politically to take legislative reform in the volatile and dangerous political context of the time (in which a number of CSP credit union participants were, in fact, assassinated). The development of adequate legislation and regulation is currently in progress in Guatemala. In particular, a new C-GAP[1] funded project is designing and implementing an independent Guatemalan agency to rate and certify credit unions. The object of the agency is to build public confidence in participating credit unions as safe deposit-taking institutions and to provide independent, external regulation of credit unions.

15. Replication

The principles, policies and discipline of CSP are regarded by WOCCU as fundamental to effective credit union development programmes. Of course, there is no single recipe of development that works everywhere. WOCCU has implemented programmes

[1] CGAP – Consultative Group to Assist the Poorest - A multi-donor microfinance agency based in Washington D.C. supporting the development of microfinance institutions. It assists increasing the poverty outreach of MFIs, improving the legal and regulatory framework for MFIs, and facilitating the commercialisation of the industry. At http://www.cgap.org/

based on the new model of development in a number of countries. In some it has worked well and in others it was not as successful. What works often depends on the local context and differs from one country to the next. But the key CSP messages about the development of credit unions as stable, safe and viable financial institutions have been found to be applicable in Europe, in Asia and in Africa just as they were in Latin America. Currently strengthening projects, based on the learning outcomes of Guatemala, are operating in Bulgaria, Macedonia, Moldova and Romania. Outside of Europe, there are similar projects in Kenya, Rwanda, Uganda, Philippines, Sri Lanka, Uzbekistan, Bolivia, Ecuador, Jamaica and Nicaragua. In most cases, these projects are funded with the support of an overseas development agency.

A particularly interesting example of the programme based on the principles and methodologies of the Guatemalan CSP is currently taking place in Romania. This USAID funded WOCU project is working to strengthen the 4,472 Romanian credit unions, known as casele de ajutor reciproc (CARs) in order to improve the availability of microenterprise loans to self-employed members. In the changing economic context of Romania, CARs have to modernise their operations both to ensure their own financial sustainability and to expand their products and services. They are changing their orientation from mainly providing cheap loans to providing safe and accessible savings services (WOCCU 2001). Romanian CAR directors and staff have developed links with, and visited, Guatemalan credit unions.

Is a CSP-type project replicable in Britain? Certainly many of the principles, policies and disciplines of credit union management, as exhibited in CSP, are currently being adopted by ABCUL in its efforts to modernise the British credit union movement. In particular, the PEARLS monitoring system is being introduced as a standard credit union management tool. There is also a focus on ensuring that pubic funding agencies adopt an approach to credit union development that is much more business and market-oriented. Forthcoming new credit union development guidelines, to be issued by the Local Government Association in September 2001, will reflect the changing approach to credit union development. Undoubtedly, public funders, including central and local government, would be assured of greater success in assisting credit unions to become self-sustaining financial institutions, able to offer quality services to large numbers of low income

members, if they adopted, in funded programmes, something of the rigour, discipline and focus of the Guatemalan CSP.

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